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MORTGAGE BANKING

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Lenders are being buffeted by change in just about every corner of the mortgage business. Competitive pressures, the smell of recession in the wind and stalled appreciation in some bellwether markets has mortgage lenders wondering about the future. But the future is difficult to forecast because the industry is going through the very eye of a hurricane now that will leave behind changes that will reshape the business permanently.

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Changing Times

The Middle East has shaken up the outlook—there's no question. But if that were not on the front pages, there would be plenty of other news making the economy's prospects shaky. The housing markets are another story altogether—or rather several stories. In some regions, we hear from some strong originators that the year is pulling ahead of last year in terms of production numbers. In other places, the news is that business is flat or hurting.

But the news that the business cycle is alive and well is not really big news. And the inflation hit caused by huge jumps in oil prices just makes an already shaky, debt-burdened economy more wobbly. Again, nothing new there.

It is the mortgage industry itself that is undergoing headline-making changes. The RTC is now redistributing the wealth long held inside local and regional thrifts. New players are stepping up to the counter to give those assets a new home. So, on this beat, we believe one of the really big headlines of the year is that a mortgage insurer has finally crossed the line into the servicing business. Those deep pockets of General Electric Mortgage Capital Corporation have finally been tapped, as many have long speculated they would be, to enter the servicing business. With servicing prices at bargain basement levels, we should be in for a series of headlines in the coming months on a cadre of new, well-heeled, servicing novices.

New approaches to production are also giving the traditionalists a run for their money. The talk here is about new "distribution channels." Will explicit Realtor-mortgage lender alliances work? Is telemarketing mortgages a viable business plan? It's too early to tell, but all eyes are on the pioneers.

Janet Reilley Hewitt
Editor in Chief

Editor's Note: An article in the August issue titled "Wholesale Competition" was based on the results of a study co-sponsored by Mortgage Dynamics, Inc. The article omitted mentioning that MDI's managing directors, Mary Bruce Batte and Dan Measell, conceived the study and were instrumental in its actual development and design.

COMING IN NOVEMBER

Next month we will explore different approaches to bringing in mortgage business. The subject is marketing and how lenders are using it to their advantage.

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Winds *of* Change

The business of mortgage banking will be done differently in the future. Not much time is left to change the sails, but here's a look at which way the wind is blowing.

Fred Portner

The marketplace is lecturing to those of us left in the mortgage business. If you were to pause and take a moment to listen, this is what you would hear: "Say hello to the person on your left and your right. At the end of the year, two of you will be gone."

I wonder if the marketplace's lecture to us has our full attention?

The mortgage banking industry is undergoing the same permanent structural change as the rest of the financial service business. And as we already know, bankers and thrift managers are seeing the competitors on their right and on their left—or themselves—disappear.

Consolidation is one of the inevitable results of the rationalization of any fragmented business. But consolidation and the elimination of weaker firms is not the only structural change being faced today in mortgage banking. A few other key issues are exacerbating the pressures of this transition. These other issues include price erosion, unchecked cost escalation, meager investment in technology and inadequate management capabilities.

The inevitable companion to industry consolidation is intensified price competition. The traditionally high margins of the industry attracted numerous additional competitors in the 1980s. This additional competition, plus the end of the 1980s demand bubble caused by refinancings, has resulted in a marketshare struggle carried out at least in significant part through price competition. The net result is likely to be a permanent reduction in effective prices.

In terms of the issue of unchecked cost escalation, historically we have not been a cost-conscious industry, but rather volume-conscious. As a result, unit costs have continued to escalate, even in the face of declining demand. We haven't succeeded in adjusting our operations quickly enough to the new realities of production.

To further try the hand of the industry's leaders, this business has not made the most of available technology. Historically, we have spent little money on technology, or worse—where we have spent lavishly, the results have been dismal. We are an industry crying out for help in improving productivity, yet have little positive experience in applying the tools of technology to assist us.

Finally, industries in transition demand much deeper and broader management capabilities than do stable industries. The breadth of management capabilities in mortgage banking is thin relative to the current challenges being faced.

Furthermore, the transition from a fragmented industry is being abetted by pressures from regulators and the banking and thrift industries' performance. These pressures will further alter the competitive landscape.

The impact of the changing roles of thrifts and banks in the competitive landscape is significant. On balance, the mortgage industry is trading out one substantial competitor—thrifts— for another—banks. This new competitor, however, is better capitalized, managerially deeper, and technologically more resourceful. There is no question that thrifts must change their posture toward mortgage lending/banking. Growth constraints created by tougher capital requirements are dampening the often irrational pricing practices of the past, and, therefore, throttling unbridled production strategies. Rules relative to capitalized servicing are reducing thrifts' aggressiveness toward purchased servicing.

As thrifts reduce their aggressiveness, commercial banks have compelling reasons to accelerate their mortgage banking strategies. The new risk-based capital regulations encourage banks to hold residential mortgage assets. In addition, there is generally a scarcity of other attractive lending opportunities currently available. Finally, banks are believers in

ILLUSTRATION BY STEVE McCRACKEN

building retail relationships, with mortgage lending providing a key vehicle for doing that. It is true that, as with thrifts, the new capital regulations discourage purchased servicing by banks, but only in extreme capital situations. Most large banks have significant room for additional goodwill in the form of purchased servicing.

The entry of major new competitors during any wide industry structural transition usually results in permanent changes to the competitive environment or, in other words, how the business is actually done. Although slow to evolve, this is also happening in mortgage banking.

The entry of heavily capitalized competitors such as Sears Mortgage Corporation, Citicorp Mortgage, Inc. and Prudential Home Mortgage accelerated the development of private securitization, which in turn redefined the pricing and documentation requirements for the largest segment of the industry—low-LTV, conventional lending. Technology investment has accelerated, resulting, for example, in 15-minute loan approvals (using artificial intelligence), effective remote processing and, perhaps, significant changes in the scale economics in servicing.

Another way the competitive environment has changed is that new delivery channels have been developed. Retail branch production is but one way to reach consumers, and is probably not the most efficient in many cases. Direct mail/telemarketing is proving viable, Realtor-builder/lending partnerships have flourished and the wholesaler-broker distribution combination has become a dominant force in several of the largest markets.

So, without a doubt, the way we conduct the business is changing. And it will continue to change, pressured by the new competitors with new ideas and a lack of historical bias and culture to overcome.

Transitions are painful

Make no mistake about it, structural transitions are not fun for most people in any endeavor. A whole way of working and living is being upset. Uncertainty is heightened, positions and, indeed, self-esteem and confidence are threatened. Resistance is the first and natural response.

Unfortunately, the characteristics of our industry are not well suited to ease the transition and the attendant natural threats to its work force. Mortgage banking is not a business with high research and development (R & D) expenditures. Typically, we do not invest a lot in new ideas. As a result, we are not accustomed to regularly trying new ideas. Any expenditures in R & D are an incremental cost to us, at a time when cost pressures are already substantial.

The message for our industry is not that the sky is falling, or that all is lost.

Existing mortgage banking management teams have little experience in testing or implementing alternative solutions. Merely learning how to go about investigating new alternatives, while still managing current business, is a significant challenge; one which typically results in pushing the whole issue of addressing needed changes down the priority ladder.

The key resources present within the industry today are not the right ones to lead the changes. Real consumer marketing talent is very thin within the industry and deep, practical technology and process-management talent has not been acquired. As a result, the two key areas of expertise—marketing and technology—are not available in quantity to provide the conceptual leadership necessary for the current industry-wide transition.

The net result is regrettable, but predictable. There is a strong, natural resistance to change and a lack of clarity about the solutions or how to get them implemented. The actions taken, therefore, tend to be traditional, short-sighted, short-lived solutions to the issues—cut staff, shave commissions, price competitively and pray for greater volume, or hire consultants and relinquish responsibility for the problems to them. However, this structural transition is a strategic issue we cannot run or hide from. It must be met head-on, with an open mind and a commitment to change

Learning from other industries

If mortgage banking's managers can't hide, then where can we look to gain perspective on the challenges they now face and, more importantly, find the logical solutions? Surely, mortgage banking, and financial services in general, are not the only fragmented industries that have undergone structural change. Several industries have, in fact, experienced similar changes during the past two decades that mortgage banking is now facing. Those industries include airlines, trucking, investment banking and the grocery business.

While the exact nature and results of each of these industry-wide consolidations was different, there are some critical similarities that provide relatively unambiguous insights into what we should expect in the mortgage banking industry.

The outcomes of those other industry transitions produced fewer competitors. Not just a handful of competitors resulted, but it typically produced a bifurcation of the business between a few, very large, competitors and many very small players, with a dwindling of mid-sized competition. This is understandable, as the two groups select the specific basis on which they will compete. Big players capitalize on scale economics and technological and marketing sophistication to differentiate themselves, while small players focus on speed, flexibility and an absence of overhead. Mid-sized players tend not to be able to win against either of the strategies, with the marketplace becoming less and less tolerant of simple "me-too" competition.

As these other industries have shown, transitions also produce better cost economics. It is axiomatic that cost structures change, that is, improve, dramatically as industries consolidate. The cause of the improvement, however, is not just size.

In fact, it rarely is. But rather it is usually fundamental changes in the entire delivery system for the product. Fresh eyes, not blinded by history, literally dismantle the parts of the business and then reconstruct them, using superior marketing, technology and process management skills. But, however obtained, unit costs are improved significantly through the structural consolidation of the industry.

Another side effect of these industry-wide transitions is a crisper focus—"All things to all people," and "volume of any kind from any price" are no longer valid management principles. The winners clearly and carefully select what product, geography and type of distribution segments in the business that they want to compete. They also decide specifically how they will compete. The focused competition stands a chance of winning, the non-focused competitor almost surely vanishes.

The final by-product yielded by the structural change that reshaped those other industries was frequently different management. Over time, any industry attracts, develops and maintains the kind of managers needed to be successful. As the rules of the game change, so do the management requirements. Structural consolidations fundamentally change the rules of the game and the concomitant managerial requirements. More often than not, the existing managements find it difficult or impossible to learn or adjust. The necessary knowledge must be imported from outside the industry, and the existing culture must be modified to assimilate effectively this new perspective and style.

The sky isn't falling

The message for our industry is not that the sky is falling, or that all is lost. There will continue to be a very viable mortgage banking industry. Demand for mortgage loans will continue, albeit subject to cyclical pressures. Therefore, there must be someone to deliver the service. And if demand is present, the economics of the business will adjust over time to be acceptable for the better competitors.

Clearly the business must change to remain viable. One undebatable conclusion is that unit costs of production must be reduced. Price increases aren't likely and increased volumes

One undebatable conclusion is that unit costs of production must be reduced.

can't be depended on to bail the industry out. The profit margin structure of mortgage production has worsened intolerably for the average production operation.

Fifteen years ago, production overages were normal, one could reasonably bank on marketing profits, and the value of servicing was not yet recognized in the marketplace. Some 300 basis points in total revenues were reasonable to expect (See Chart 1). Costs were contained, principally by a lack of intensive competition. The net results were often branches with direct production profits and very strong "full economic" profit margins.

Now that is no longer the case. For the typical firm, production is a net cost and a substantial one. It is not unusual to see a 70 basis point net direct cost of production. Marketing profits have disappeared (unless the company manages its pipeline uncovered), and despite an increase in the value of servicing, the typical firm is fortunate to break even on a full economic basis. Moreover, in the current environment with servicing values temporarily depressed, the full economic value of production may even be negative. Firms must either adapt in various ways to reduce their unit costs or suffer a gradual liquidation of their equity bases.

Another way that the business must adapt is by finding a way to reach the consumer more efficiently and effectively. The historic, ubiquitous, branch-based delivery system, with essentially no formal consumer marketing support, must give way to more and better ways to reach the consumer. Two hundred basis points to produce a loan in a branch is not tolerable.

Depending upon an intermediary, such as a builder or Realtor, to generate every piece of business almost guarantees a price-based, high cost-of-acquisition production approach. As more home buyers in the 1990s move-up and become more knowledgeable borrowers, the need to deal through an intermediary diminishes. Efficient direct marketing becomes a viable alternative to a singular reliance on branch-based production.

Today's mortgage lenders must also rationalize their documentation standards. Documentation requirements in large measure dictate not only the cost structure of the business, but also relative access to major segments of local markets. Consequently, this aspect of production influences unit costs from two perspectives—branch scale and individual functional costs.

Traditionally, mortgage bankers adhered to the documentation requirements of their principal investors—the agencies—accepting the requirements as merely a cost of doing business. Now, however, it is a cost that must be challenged at every turn. Alternative investors with documentation levels better rationalized by quality of credit and borrower, permit streamlined cost of production and greater customer service. Failure to challenge documentation requirements reasonably, and make active trade-offs between the depth of documentation and its cost, ultimately will take its toll on indi-

Chart 1

Production Expenses and Revenues
1975 versus 1990

(in basis points)	1975±	1990
Revenues		
Origination revenues	1.50%	1.30%
Servicing value	1.00	1.50
Marketing profits	.50	0.00
Total revenues	3.00%	2.80%
Expenses		
Direct branch cost	1.30%	2.00%
Production support/admin	.15	.30
Corporate overhead	.25	.50
Total expenses	1.70%	2.80%
Net revenue	1.30%	0.00
Pretax profit margin	43.00%	0.00

vidual competitors in terms of cost and marketshare positions, thus almost guaranteeing weak or non-existent profitability.

Documentation standards should be completely adjusted to meet the varied risks posed by product and type of customer segment, rather than blindly applied across the business.

If there is one key to future success that all mortgage bankers can act on relatively quickly, it is the concept of focus. Understanding what customers, geographic markets and what specific products the firm has, and then structuring the entire firm to focus on these areas, is critical to succeeding in a consolidating industry.

It requires thinking and courage to make tough personnel decisions, but it doesn't usually require extensive investment. Most mortgage bankers know "where their bread is buttered." Getting rid of areas that do not contribute to the overall success of the firm is not is a major step toward survival.

Another principle that needs to be embraced by managers that want to prosper in the new competitive environment is the co-equal management of all pieces of the business. Mortgage banks are typically production-driven companies. Sales management dominates. If we are to survive, operations and secondary marketing must assume co-equal influence and attention. Integrated mortgage bankers will not survive without secondary marketing capabilities that are well beyond merely being able to sell product to the agencies or conduits. Nor will they be able to turn sales into profits without skills in the operations area.

Change creates opportunities

Change is not necessarily bad. Change always creates as many opportunities as threats. The rules for success are merely altered. The seemingly paradoxical behavior of individual mortgage banks in recent times reinforces the dual-edge condition present in today's mortgage lending business environment.

In the area of retail production, for example, we have seen Lomas Mortgage USA, Dallas, close or sell off its retail branch network, concluding that it cannot make the business adequately profitable. The industry has also witnessed numerous other mortgage banks either leave the retail business completely, reduce their networks, or switch to wholesale production due to the apparent high cost of retail production. Yet other competitors, such as Norwest Mortgage, Inc., Des Moines and Countrywide Funding Corporation, Pasadena, are aggressively, or at least selectively, expanding their retail networks. Why? How can the business look so bad to some competitors and so good to others?

The ultimate winners and losers in the servicing business are beginning to emerge.

A second paradox in retail production is the simultaneous exodus of firms with large branch networks and the tremendous expansion of mortgage brokerage operations. What is it in the economics of the production business that makes the origination business attractive to prospective brokers and yet negative to branch network-based competitors?

In another aspect of the business, servicing values are down, markedly. Therefore, servicing is not attractive, or is it? Obviously, it depends on whether you are selling or buying. For the firms with a large servicing portfolios that are neither buying or selling in significant quantities, the situation is neutral. The real economic value of servicing has not changed appreciably.

For the originator who must rely upon servicing-released sales to cover production costs, the changes taking place are a catastrophe. The cash value of his product has declined as much as 30 percent in recent months. However, for the firm considering building or expanding its servicing business, the situation is perhaps singularly attractive. Potential returns on new servicing acquisitions are the highest they have been for more than 10 years. This is a situation that may not be repeated for some time. It is a critical period for building market position in the servicing business.

Is this paradoxical competitive behavior? Absolutely. But it is entirely rational. The structural dynamics are creating enormous opportunities as well as hardships. The competitive dynamics at work here will help explain the paradoxical behavior.

Traditional branch operations are indeed largely unprofitable. Such operations typically entail small average-branch size, low productivity and products sold at razor-thin commodity-like margins. Lomas and Nettleton, to use that example, was unable to change its equation sufficiently to make a difference. It validated the unacceptable profit dynamics of the traditional branch. There is a need to change the delivery system to make retail branch unit costs acceptable.

Presumably, Norwest, a company that is pursuring a branch building strategy, will do so by concentrating on high-balance or at least low-documentation credits, enabling its branches to build larger volumes with lower unit costs, fundamentally altering the branch economics. It is the same strategy the major thrifts have deployed successfully for years.

Countrywide has chosen a different, yet apparently successful strategy. It has focused on the high cost of originators, reducing or eliminating this cost, accepting lower average-branch volume, but producing this volume at a lower cost. They have also substituted direct mail marketing for the loan originator. Whether this combination of strategies is defendable over the long term is not clear, but it has helped Countrywide bridge a perilous period in the business.

How can mortgage brokers make it when branch networks can't? Relative cost advantage is not the answer. The combined cost of the wholesaler and mortgage broker or correspondent is almost certainly greater than that of the branch network. Then what is fueling this transition from retail branch networks to mortgage brokers?

One answer is a willingness by brokers and wholesalers to squeeze more of the profit margin out of the business to win production. Branch network-

based competitors still largely price their products directly off the secondary market, without adjusting prices for servicing value. Wholesalers readily price their product to their customers with either an explicit or implicit servicing-release fee. It is implicit if it shows up as a lower net price to mortgage brokers or explicit if servicing-release fees are quoted separately. In either case, the net result is a lower "street" price for the originator than that which the typical branch network can quote. Business looks good to the wholesale originator, terrible to the branch network.

The other answer is probably just as important. Mortgage brokers tend to win in head-to-head competition with branch originators because they are better and more seasoned marketers. Typically, they have established clientele who come to them because of service as much as price. Despite the focus on price competition, mortgage production is still as much service-based as it is price-based. The proliferation of mortgage brokers reinforces the importance of customer service in the equation for successful retail production.

Finally, in the area of servicing the dynamics are reasonably clear. The following configuration of: excess supply in the form of RTC-controlled servicing, which ultimately will be placed back in private hands; plus the loss of traditional competitors (the thrifts); and the change in capital regulations that dissuade purchased servicing; has resulted in a temporary buyers' market. Clearly, the situation is temporary, since the true economic value of servicing hasn't changed materially.

The ultimate winners and losers in the servicing business are beginning to emerge. However, some of the more logical long-term winners have yet to buy into the business. Some of the logical candidates to emerge as buyers of servicing and potential buyers with special reasons not to buy into the servicing business, warrant a brief discussion.

Public companies are disadvantaged. Servicing is a wonderful cash flow business. It is only a fair reported earnings business under typical purchased servicing prices. Mutual insurance companies are naturals, given the lack of focus on reported earnings, cash reserve buildup opportunity, plus the opportunity to acquire attractive assets in large quantities and control the quality of asset servicing. Private ventures to buy servicing rights are attractive. Tax-sheltered investments are possible. Banks should be willing to provide the necessary leverage, having a predictable cash flow as collateral.

The structural pressures in the industry will continue for some time. The restructuring of the industry is nowhere near completion.

Scale economics may ultimately prove a significant differentiator among competitors. But to date, that has not been the case. Therefore, it's not likely that a handful of firms will control a majority of the servicing. For portfolios larger than say $4 to $5 billion, servicing unit costs have been largely a function of servicing location (labor costs/quality), portfolio mix and operational management skill, not size.

Sidestepping the threats

The structural pressures in the industry will continue for some time. The restructuring of the industry is nowhere near completion. In order to transform threats into potential opportunities, there are several critical issues that each firm must sort out and incorporate explicitly into its strategy.

The starting point to develop a viable survival strategy is understanding clearly the competitive environment. Banks, thrifts, independent mortgage banks and mortgage brokers are all in a state of flux. Each has some relative strengths it can exploit, as well as some particular vulnerabilities. Since it is no longer feasible to be all things to all people, it is critical to determine explicitly the answers to three specific questions.

What are your comparative strengths—and weaknesses—relative to each type of competitor? Which market segments are ones where you can have a relative advantage or the places where your relative advantages can be best applied? How best can you apply your relative advantages to win and defend marketshare?

Much is written about competitive strategies, and most of it is conceptually correct. Unfortunately, in the press of daily management, most of it is forgotten or ignored. Ignoring the incisive development of a competitive strategy now may be tantamount to failure.

Theorists would lead us to believe that, as a paper intensive business and, therefore, subject to scale economics and technology, servicing increasingly will become concentrated in the hands of a few "megaplayers." Clearly, some very large servicers are emerging. But it is doubtful that they will become so efficient as to make the business uneconomic for others.

It is important, however, for each mortgage banker to understand and come to terms with the amount of continuing investment that will be required to stay competitive in terms of servicing costs, particularly as cash flow demands cause more churning of servicing portfolios. Each competitor must determine whether it is in the production or servicing business, or both. The skills to manage both businesses are significantly different, with a marketplace now much less tolerant of mediocre management in either business.

Finally, to prosper in the new marketplace, production costs must come down substantially. But how? Retail branch production will continue to be the primary distribution channel. It is not something most firms can abandon. Solutions must be found to reduce branch costs permanently.

Increased average-branch size is clearly one answer. There are pronounced scale economies in retail branches. According to the latest survey by ICM Consultants, Bala Cynwd, Pennsylvania, direct unit cost (in basis points) of mortgage originations fall dramatically as branch size increases.

The unit production costs dropped from 200+ basis points for branches under $25 million in production volume to almost 100 basis points for branches over $125 million in volume, according to the survey.

Cost-effective production translates into the challenge of winning a major share of any market in which the company competes, not a small share of numerous markets.

But size alone is not the answer. Few individual communities will support single branch production of more than $100 million. To realize these scale advantages, which are primarily processing rather than sales-related, a crucial part of retail strategy must be to find ways to concentrate processing without diminishing customer service. That is a tough order, but not impossible.

Branch costs also are not influenced simply by size alone. Size alone does not overcome poor productivity management. The branch is an information factory, one in which information must be processed efficiently and quickly. Very few mortgage banks have yet made much headway in turning their branches into such operations.

The use of technology will help in the battle of scale and efficiency. Yet it cannot be blindly or carelessly applied. Making major inroads into cutting branch costs means fundamentally redesigning the branch distribution system, with technology as the catalyst allowing this to happen.

A critical question in making the future a place where we cash in on opportunities is this one: How do we kill the paper?

Mortgage banking is among the most egregiously paper-laden businesses ever created. We are on the verge of becoming overwhelmed by the paper deemed necessary to produce quality loans. Or are we? We are actually in an information management business—gathering, processing and disseminating information. The technology now exists to eliminate most of the paper we create. How well we address this issue over the coming years will play a central role in keeping individual firms competitive, as the required level of sophistication—that is, the cost of entry into the game—escalates.

On the issue of quality versus cost, experts tell us we do not face a trade-off between quality of production and cost. They maintain that, in fact, quality and cost go hand-in-hand. Conceptually, this is correct. Firms noted for high quality performance also tend to be lower cost firms. However, we cannot continue to add complexity to our production process where it is not needed. Consumers will reject our demands and go to competitors who have simpler loan application processes. We must individually, and as an industry, better address the balance between reasonable assurance of the quality of the assets being generated and the cost of producing this level of assurance. It cannot remain a relatively one-sided issue.

Speed is increasingly becoming an important solution to several key survival issues.

Finally, speed is increasingly becoming an important solution to several key survival issues: production differentiation; processing costs; and pipeline exposure and risk.

The winners will manage very aggressively the time it takes to approve the typical loan application. Speed is, and will grow in importance as, a competitive weapon. This will require, in many cases, fundamentally changing attitudes in individual companies—shaking up complacency regarding the time it takes to accomplish individual production tasks and eliminating excuses as to why things can't be done more quickly.

Even though we don't control others that must supply us with information in the production process, we can manage much more effectively the timeliness of information we receive from others. Speed may, in fact, become the best attack weapon we possess against competition, cost and risk.

The successful solutions for each company may vary, but the specific challenges they face are essentially the same. There are five common challenges we must all address:

Develop a clear conceptual perspective—No simplistic solutions are likely to be adequate. We are not facing normal industry cyclical changes, but fundamental changes in the way our business is conducted. Each management must have a clear conceptual understanding of what is happening and why, before developing effective responses.

Proper strategic positioning—Each firm must select a specific strategy that is correct for its resources and competitive environment. Unrealistic strategies from either a competitive or internal resource perspective will lead to failure. The margin for error that existed historically is no longer present.

Commitment to change—It's easy to talk about and plan change, but it's painful to develop and maintain a commitment to change. This is particularly so when it involves, as it inevitably must, difficult people and culture decisions. Good planning will accomplish little if the intestinal fortitude to execute the plan is not present.

Intensive effort—This is not business as usual. It will take extraordinary energy both to implement a new order of things while managing effectively the current business. Without properly channeled intensity, it will not get done.

Supplementing the management teams—Reconstituting the management team to supplement it with additional talents is a difficult task, requiring tremendous executive courage. But the changes we face require perspectives and expertise not present in the typical mortgage bank. They must be imported and assimilated effectively to make a difference.

The world our industry faces is not hospitable. There are, to be sure, very significant threats to the survival of each of our firms. But just as certainly, there are substantial opportunities for those competitors that seize them. Mastering the changes required can lead not only to survival but prosperity. Continuing to manage the business as usual will almost certainly lead to extinction. **MB**

Fred Portner is executive vice president of Directors Mortgage Loan Corporation, Riverside, California.

THE TRENDS AND OUTLOOK FOR FORECLOSURE & DELINQUENCIES

ILLUSTRATION BY JOHN HENLY

Problem loan rates are now nearly double what they were in the late 1960s.

Thomas M. Holloway and Robert M. Rosenblatt

Servicing residential loans is the bread and butter of the mortgage banking business. When loans become delinquent, servicing income is undermined. When they go into foreclosure, servicing value is lost. Consequently, the outlook for delinquency and foreclosure rates is of critical importance to mortgage bankers.

During the 1980s and now in early 1990, there has been cause for concern. Problem loan rates are considerably higher now than they were in the 1960s or 1970s. Although the performance of many categories of problem loans appears to have shown some improvement in the past few years, only modest improvement has occurred in the most severe categories, that is, loans 90 days or more delinquent or in foreclosure.

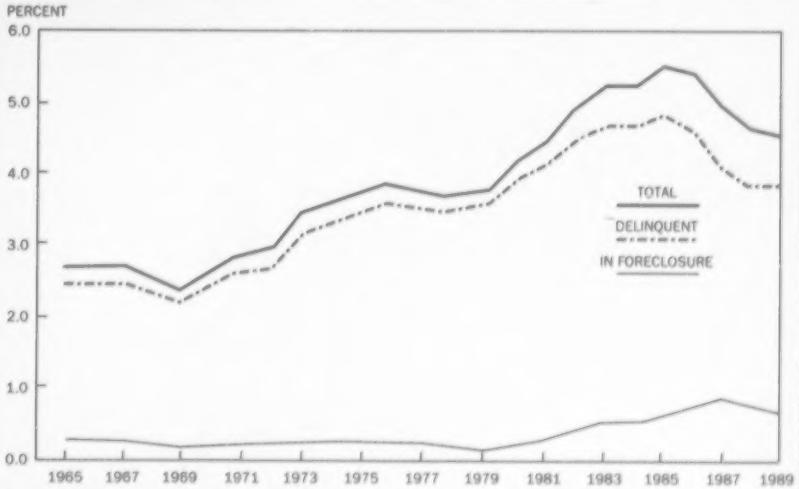
This article analyzes trends in delinquency and foreclosure rates, examines the causes of defaults and discusses the outlook for problem loans.[1]

Some of the key findings and most important conclusions include:

- Problem loan rates (delinquencies and foreclosures) rose steadily from the mid-1960s to 1985, before declining in the past few years. Still, problem loan rates currently are nearly double what they were in the late 1960s.
- From 1965 to 1989, the number of delinquent loans rose 265 percent and the number of loans in foreclosure increased 590 percent.
- FHA problem loan rates have been consistently higher than conventional or VA problem loan rates.
- During much of the mid-1960s to 1989, problem loan rates were highest in the Northeast, but problems soared in the South during the 1980s.
- The collapse of energy prices resulted in a sharp increase in problem loan rates in energy states, but was not sufficient to account for the general rise in problem loan rates in the U.S.
- Higher problem loan rates on ARMs during some years in the 1980s and their growing share of total loans outstanding drove up the national problem loan rate in some years, but was not sufficient to account for the general rise in U.S. problem loan rates.
- Changes in 60-day and 90-day delinquency rates provide useful guides to future changes in the percentage of loans in foreclosure.
- The amount of home equity is a crit-

CHART 1

Problem Loan Rates
(Percent of Loans Serviced)



Source: Mortgage Bankers Association

ical determinant of default rates—this was underscored by statistical tests done for this article. Because home price appreciation is one of the most important determinants of equity, it plays a key role in explaining trends in default rates.

- Changes in the unemployment rate, consumer debt burdens, loan-to-value ratios, and, perhaps, divorce rates also help explain trends in problem loan rates.
- Personal bankruptcies are significantly contributing to the costs of loan problems.
- Problem loan rates are not likely to continue to fall in the early 1990s, but they are not likely to reverse course and rise either. Rather, they are expected to remain roughly at current levels.

National trends

During the late 1960s, the problem loan rate—delinquent loans and loans in foreclosure as a percentage of total loans serviced—stood at about 2½ percent (See Table 1 and Chart 1)[2]. Sharp increases during the first half of the 1970s moved the rate up to around 3¾ percent, where it remained during the latter half of the 1970s. Further sharp increases in the first half of the 1980s pushed the rate to about 5½ percent in 1985 and 1986, before it fell to a little more than 4½ percent by 1989. Even with the recent declines, however, the problem loan rate still is almost double what it was in the late 1960s.

Delinquencies comprised the bulk of problem loans throughout this period. The delinquency rate drifted up through the 1970s and early 1980s, peaked in 1985, then declined. To a large extent, this pattern reflected movements in 30-day delinquencies, which rose during most of the period, peaked in 1985, then declined sharply. Unfortunately, the most severe delinquency category—loans 90 days or more delinquent—did not fare as well. In the late 1960s, the rate was about 0.2 percent; by 1985, it had reached 0.8 percent—a fourfold increase. It was still relatively high in 1989 at 0.6 percent.

Foreclosure problems did not improve much either. In the late 1960s, only about 0.2 percent of loans serviced were in foreclosure. By 1987, the rate more than quadrupled to 0.9 percent, and was still 0.7 percent in 1989.

The upshot is that most of the improvement in the problem loan rate in recent years came in the least severe category of delinquencies—loans only 30 days delinquent. Significant problems remain with longer term delinquencies and loans in foreclosure.

The upward trend in delinquency and foreclosure rates coupled with the steady rise in the number of loans serviced caused a dramatic increase in the total number of problem loans. In 1965, about 465,000 loans were delinquent and another 45,000 were in foreclosure. By 1989, about 1.7 million loans were delinquent and another 300,000 were in foreclosure—increases of roughly 265 percent and 590 percent, respectively.

Trends in loan problems among conventional, Veterans Administration (VA), and Federal Housing Administration (FHA) loans were similar, but not identical. Conventional loans, which constituted about 75 percent of loans serviced in 1989, had lower problem loan rates throughout the period. Further, their improvement since peaking at 4.6 percent in 1985 has been greater than the improvement in either VA or FHA loans. Still, conventional loans, like their government guaranteed or insured counterparts, had significantly higher problem loan rates in 1989 than in the late 1960s. The conventional rate was about 1¾ to 2 percent in the late 1960s, but was about 3½ percent in 1989. Much of the increase was due to rising delinquency rates, but loans in foreclosure also shot up from 0.1 percent to 0.5 percent by 1989.

The FHA problem loan rate in 1989 was more than twice the rate of the late 1960s despite some improvement since 1985. Throughout the period, the FHA problem loan rate exceeded the rates of VA and conventional loans, sometimes by very wide margins. This outcome is not surprising, however, because the FHA program is designed to serve a portion of the low and moderate income market that the private sector often will not serve as well as borrowers that may be ineligible for VA programs.

The improvement in the FHA problem loan rate since 1985 was primarily due to a sharp improvement in delinquency rates. In 1989, loans in foreclosure remained high, with about 1¼ percent of FHA loans outstanding in foreclosure.

Problem VA loan rates did not deteriorate as much as FHA rates from the late 1960s, but they did not improve as much since 1985 either. The VA problem loan rate remained at about 7½ percent from 1985 to 1989. The delinquency rate peaked in 1985, then came down, but the rate of loans in foreclosure continued to rise through 1988, before declining very modestly in 1989. Like FHA loans, nearly 1¼ per-

CHART 2

Conventional Problem Loans, 1980
(Percent 90+ Days Del. or in Foreclose.)

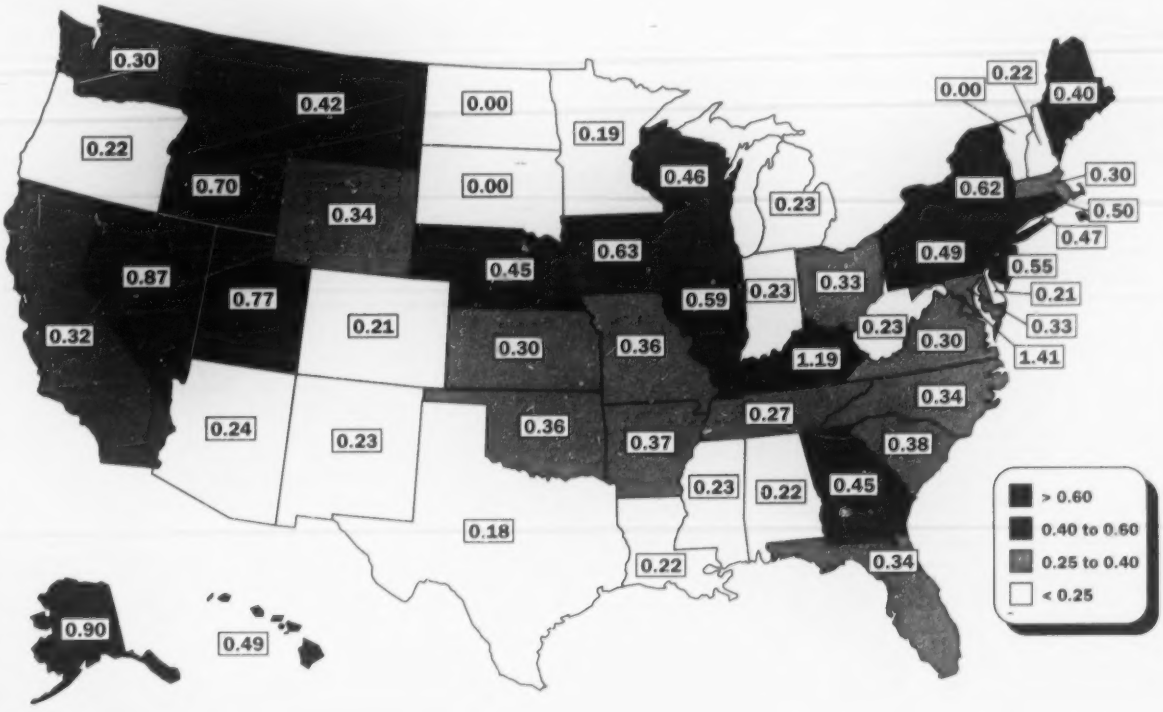


CHART 3

Conventional Problem Loans, 1988
(Percent 90+ Days Del. or in Foreclose.)

TABLE 1

Problem Loan Rates
[Percent of Loans Serviced]

		Delinquent Loans				
	Total	Total	30 Days	60 Days	90 Days or More	Loans in Foreclosure
1965	2.7	2.4	1.8	0.4	0.3	0.2
1966	2.7	2.5	1.8	0.4	0.3	0.2
1967	2.7	2.5	1.8	0.4	0.2	0.2
1968	2.5	2.4	1.8	0.4	0.2	0.2
1969	2.4	2.2	1.7	0.4	0.2	0.2
1970	2.6	2.4	1.7	0.4	0.2	0.2
1971	2.9	2.7	1.9	0.4	0.3	0.2
1972	3.0	2.7	2.0	0.5	0.3	0.3
1973	3.5	3.2	2.3	0.5	0.3	0.3
1974	3.6	3.3	2.4	0.6	0.3	0.3
1975	3.8	3.5	2.5	0.6	0.4	0.3
1976	3.9	3.6	2.6	0.6	0.4	0.3
1977	3.8	3.5	2.5	0.6	0.4	0.3
1978	3.7	3.5	2.5	0.6	0.4	0.2
1979	3.8	3.6	2.7	0.6	0.4	0.2
1980	4.2	3.9	2.9	0.7	0.4	0.2
1981	4.5	4.2	3.0	0.7	0.5	0.3
1982	5.0	4.5	3.1	0.8	0.6	0.4
1983	5.3	4.7	3.2	0.8	0.7	0.6
1984	5.3	4.7	3.2	0.8	0.7	0.6
1985	5.5	4.9	3.3	0.8	0.8	0.7
1986	5.4	4.6	3.1	0.8	0.8	0.8
1987	5.0	4.1	2.7	0.6	0.8	0.9
1988	4.7	3.9	2.6	0.6	0.7	0.8
1989 (p)	4.6	3.9	2.7	0.6	0.6	0.7

Source: Mortgage Bankers Association
(p) = Preliminary.

cent of VA loans outstanding were in foreclosure in 1989.

For mortgage bankers, the problem is especially acute with respect to VA loans due to the "no-bid" situation. VA no-bids arise when VA opts to pay the guaranty—a maximum of $36,000 currently—rather than take possession of the property and pay off the full amount of the loan. VA takes such an action when it would lose less by doing so than by taking possession and selling the property. When a no-bid occurs, the servicer takes possession of the property and invariably loses money on the subsequent sale.

With about 2¼ percent of VA loans 90 days or more delinquent or in foreclosure, many additional claims are likely to arise. Increasingly during the 1980s, VA chose to respond to claims with a no-bid. Because mortgage loan servicers lose substantial amounts of money on virtually every no-bid, improvement in the performance of VA loans could significantly improve the profitability of these servicers. However, few signs of improvement in VA loan performance have emerged at present.

Problem loan rates are considerably higher now than they were in the 1960s or 1970s.

Regional trends

Patterns of change in regional delinquency and foreclosure rates and the levels of those rates underscore pronounced differences in the components that shape the national averages.

During most of the 1965-1989 period, the Northeast had the highest problem loan rates for all loan types. The region's problem loan rates peaked in 1983. The first quarter of 1983 was very near the November 1982 trough of the 1981-82 recession—then trended downward before turning up in mid-1988.

The improvement in Northeast problem loan rates following the recession until mid-1988 generally tracked patterns of economic growth in the region. Robust growth in the Northeast during the 1980s surprised many observers who expected the region's economic sluggishness during the 1970s to continue into the 1980s. Instead, the near boom conditions following the 1981-82 recession drove unemployment rates to below 4.0 percent in seven of the region's nine states, before growth slowed significantly in 1988. This slowdown is probably the primary cause for the upturn in problem loan rates in the region since mid-1988.

Problem loan rates for all loan types in the Midwest and West trended upward during most of the period. VA and FHA problem loan rates peaked in 1985 in both regions, and conventional loan rates peaked in 1983 in the West and in 1986 in the Midwest. Even after substantial improvement, these regions' conventional problem loan rates in early 1989 were still 70 to 80 percent higher than during the late 1960s. The problem loan rates of VA and FHA loans ranged from 80 to 160 percent higher.

The extent of improvement in the two regions since 1985 differed by loan type. The improvement in rates for conventional loans was about the same in the two regions, but improvement in rates for government guaranteed or insured loans was slightly better in the Midwest than in the West. One possible explanation is that home prices reached levels in some markets in the West—notably in California—where homes in the middle price range locally required loans beyond the FHA loan limits or the secondary market ceiling for VA loans. If default

rates on mid-range homes are relatively favorable (low), as some evidence suggests, then the more modest improvement in problem loan rates in the West may have reflected the failure of government loan limits to keep pace with home prices.

In some ways, the situation in the South is the most troubling of the four regions. Like the other regions, problem loan rates climbed during most of the period, but, atypically, problem loan rates for VA and FHA loans in the South did not turn downward after 1985 or 1986. Further, although conventional problem loan rates in the South declined slightly after 1986, the rate remained the highest conventional problem loan rate of all of the regions in 1989, after having been the lowest as recently as 1984.

The severity of problems with VA and FHA loans in the South was exemplified by the surge in foreclosures. The percentage of both VA and FHA loans in foreclosure jumped 0.9 percentage points there from 1983 to 1989, nearly double that of the next largest increase of any other region. In short, loan performance in the South deteriorated more significantly than anywhere else during the 1980s.

Part of the South's problems, of course, stemmed from movements in energy prices. These prices began a slow decline starting around the end of the 1981-82 recession, then collapsed in 1986. This weakness in prices undercut business activity and employment in extraction industries and contributed to major economic downturns in several Southern states, notably Texas, Louisiana and Oklahoma. Because of Texas' size, the South felt the energy price collapse particularly hard; but it was not alone in absorbing the aftershocks.

Charts 2 and 3 show the sum of the conventional 90-day or more delinquency rates and the percentage of conventional loans in foreclosure by state for 1980 and 1988, respectively. The charts illustrate two important points. First, a comparison of the rates in 1980 with those in 1988 dramatically shows the extremely large relative increases in problem loan rates in energy states, such as Texas, Oklahoma, Louisiana, Colorado, Alaska, West Virginia and Wyoming, compared to most other states. Second, however, is that problem loan rates rose in many states not tied to energy production in any important way. In short, weaknesses in energy-producing states contributed to the rise in national problem loan rates, but did not account for most of the deterioration.

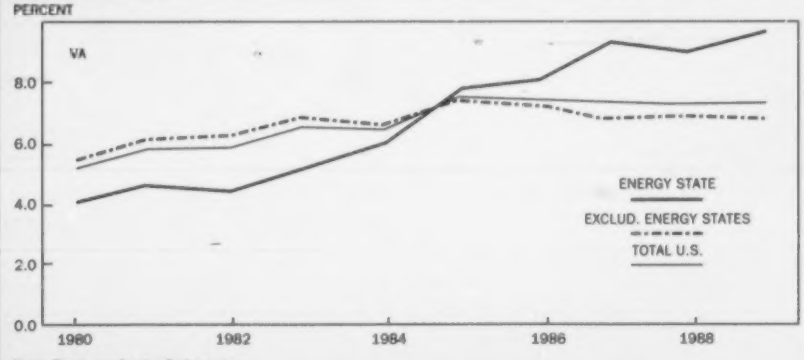
TABLE 2

Changes in Problem Loan Rates in the 1980s in Energy States and Excluding Energy States
(Percentage Points)

Loan Type	Change in Problem Loan Rates from 1980 to 1985			Change in Problem Loan Rates from 1985 to 1989		
	U.S. Total	Energy States	Excluding Energy States	U.S. Total	Energy States	Excluding Energy States
Conventional	1.5	3.9	1.1	−1.2	1.5	−1.5
VA	2.4	3.7	2.1	−0.2	1.9	−0.6
FHA	2.3	3.4	2.1	−1.0	1.0	−1.4

CHART 4

Problem Loan Rates by Loan Type in Energy States and Excluding Energy States
(Percent of Loans Serviced)



Note: Rates are for the first quarter.

The energy states consist of the 10 states with the largest shares of their total employment in 1985 in extraction industries. These include: Texas, Alaska, Colorado, Oklahoma, Louisiana, Wyoming, New Mexico, Kentucky, West Virginia and North Dakota.

TABLE 3

Variables Commonly Tested in Determining the Probability of Default and Their Expected Relationship with Default Rates

Variables	Expected Relationship with Default Rates[1]
Borrower Characteristics:	
Poor credit history	Positive
Investor rather than owner occupant	Positive
Number of years at current job	Inverse
Income growth	Inverse
Family size	Positive
Self-employed and/or commission income rather than salaried	Positive
Unemployed	Positive
Recent divorce	Positive
Income from child support or alimony	Positive
Debt-to-income ratio	Positive
Loan Characteristics:	
Loan-to-value ratio	Positive (especially if greater than 90 percent)
Loan type	FHA and VA higher than conventional Graduated payment higher than level payment Adjustable rate higher than fixed-rate
Loan age	Maximum loan problems tend to occur 3-5 years after origination
"Cash out" refinancing rather than rate reduction refinancing	Positive
Negative amortization	Positive
Contract rate below market rate	Ambiguous; borrowers try to avoid default to retain a below market interest rate; portfolio lenders may try to press foreclosure to reinvest funds at higher current rates
Property Characteristics:	
Price appreciation	Inverse
Condominium rather than single-family detached	Positive
Institutional Characteristics:	
Judicial foreclosure procedure rather than power-of-sale	Inverse
Length of statutory period of redemption	Inverse
Presence of deficiency judgments	Ambiguous; default can be more costly to borrowers in deficiency judgment states, providing borrowers with a strong motive to avoid foreclosure; lenders may press foreclosure in deficiency judgment states because they may have further recourse

1. "Positive" indicates that default rates and the variable in question tend to rise together; "inverse" indicates that default rates and the variable tend to move in opposite directions.

Carving out the energy states results does not fundamentally alter the national pattern of problem loan rates in the 1980s. Chart 4 illustrates the point using VA loans as an example. Further, Table 2 shows changes in problem loan rates in the energy states, in the non-energy states and for the U.S. as a whole from 1980 to 1985 (the latter year is approximately the peak of problem loan rates) and from 1985 to 1989. As Table 2 and Chart 4 clearly illustrate, excluding the energy states produces series that still track national problem loan rates closely. Consequently, the secular rise in problem loan rates was not caused by specific regional problems, but by broad-based national influences. A review of some recent research is a helpful way to identify some of these influences.

Results from previous studies on delinquency and foreclosure

Table 3 summarizes some of the common variables considered in delinquency and foreclosure research and the expected relationships with default rates. The table does not distinguish explicitly between delinquency and foreclosure. Some researchers have emphasized that the same factors that affect delinquency rates may not affect foreclosure rates. The opposite also holds true. While both points of view have merit, underwriters and loan administrators must focus on all factors and relationships associated with loan problems during the life of the loan. Virtually all loans are delinquent for a substantial period of time before a foreclosure proceeding is initiated. During that time, the cumulative interest in arrears may offset any equity the borrower has in the property, making it a potentially rational choice for the borrower to allow the property to go into foreclosure even if the property value exceeds the loan amount by a substantial margin.

A common point of departure among theoretical models used for studying defaults is that the amount of equity is crucial. One typical theoretical model is set up to view mortgage default as a put option, giving the borrower the right to sell the house to the lender for the principal balance. Wealth-maximizing borrowers will be increasingly likely to exercise this option whenever the market value of the house, net of all relevant transactions costs (e.g., selling costs, moving expenses, etc.), is less than the market value of the mortgage.

The increasing importance of adjustable rate mortgages (ARMs) also has been viewed by some as a fundamental cause for the sharp rise in default rates from the 1970s to the 1980s.

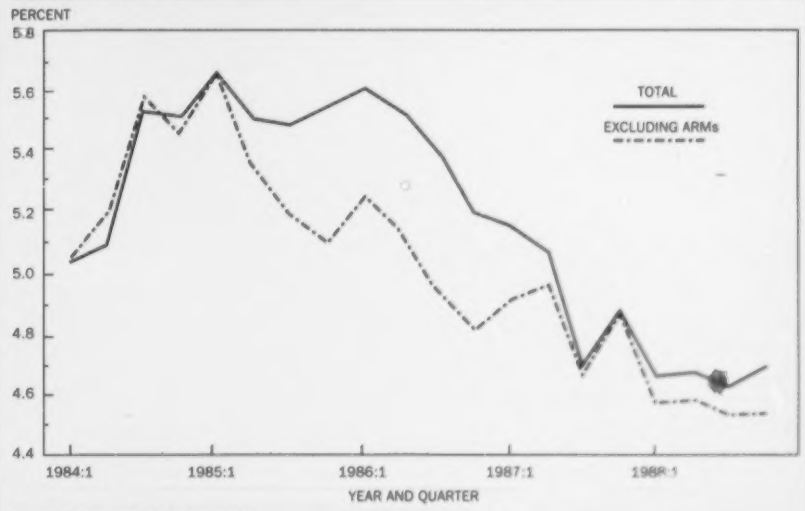
An analysis of the basic components of net equity (derived using the market rather than the par value of mortgages) suggests that initial loan-to-value ratios, home price appreciation rates, current versus contract mortgage interest rates and the age of loans should all influence default rates. The lead-lag relationships, however, between these variables and default rates are complex. For example, frequently there's a long lag from the time the fundamental conditions leading to default occur, and the time the loan goes into foreclosure. Also, some research suggests that current, negative net equity may not trigger a default if borrowers expect significant equity gains from future appreciation. In short, borrowers are concerned with maximizing their long-term wealth position, not just their wealth at any point in time. Consequently, borrowers' expectations play a key role in the outcome of a problem loan.

Defaults are most common three to five years after origination, or perhaps a bit earlier for FHA loans. This lag relationship suggests that developments during the first few years of the loan contribute to defaults and have an important impact on the loan's future.

Aside from net equity, studies have tested the effects that the following have on default rates: age, sex, occupation, payment burden (typically measured as mortgage payment-to-income ratios, with variants including inflation adjusted and nominal measures, pre- and after-tax measures and assorted combinations), marital status, number of dependents, source of income (e.g., wage and salary, commission, child support, alimony, etc.), unemployment rates and other borrower characteristics. Many of these variables are viewed as proxies for the reliability of income streams over time. In some studies, they are found to be important influences, but in others, they're not significant.

CHART 5

Problem Loan Rates Including and Excluding Adjustable Rate Mortgages
(Percent of Loans Serviced)



Source: Mortgage Bankers Association

The increasing importance of adjustable rate mortgages (ARMs) also has been viewed by some as a fundamental cause for the sharp rise in default rates from the 1970s to the 1980s. The rationale behind this view is that payment shock results in defaults as income growth falls behind payment adjustments. This would be more credible in an environment of continuously increasing interest rates. However, interest rates fell during most years from 1981 to 1985—a period when problem loan rates were rising. Further, FHA and VA problem loan rates rose sharply even though no VA loans are ARMs and only a handful of FHA loans are ARMs.

Still, ARMs appear to have greater delinquency and foreclosure problems than fixed-rate loans during some periods. These problems are magnified by the sharp rise in the ARM share of loans outstanding, from a very small share in the late 1970s, to about 10 percent in 1984, to roughly 26 percent by the end of 1988. Chart 5 shows the total problem loan rate quarterly from the first quarter of 1984 to the final quarter of 1988. It also shows the problem loan rate excluding ARMs. Both measures declined sharply between 1985 and 1988, but it is clear that ARMs kept the total problem loan rate much higher during late 1985 and early 1986 than it would have been without them. The wide gap between the two measures reflects the relatively more severe loan problems of ARMs. However, the two measures ultimately converged as ARM delinquency and foreclosure rates improved significantly in 1987 and 1988. The bottom line is that ARMs played a role in increasing loan problems during the mid-1980s, but the general patterns of problem loan rates remain even if ARMs are excluded from the mix. Therefore, ARMs alone do not account for the broader trends.

In addition to borrower and loan characteristics, the institutional framework of a state for handling foreclosure proceedings can influence the decision of a lender to foreclose. For example, if the circumstances are the same, the probability of foreclosure is lower in states requiring judicial foreclosures than in states with much less costly power-of-sale foreclosures.

The institutional framework also can influence a borrower's decision to default. Deficiency judgments are permitted in most states and allow lenders to recoup losses from the sale of foreclosed properties with negative equity by attaching claims to borrowers' other personal assets. The threat of deficiency judgments in most states almost certainly holds down foreclosure rates. California is the largest state that does not permit deficiency judgments.

On a quarterly basis, longer term delinquencies are expected to follow the path of shorter term delinquencies with a lag.

The conclusion that emerges from research on defaults is that net equity appears to be the most crucial determinant. Experience shows that if income is inadequate to meet payments, movement toward foreclosure is inevitable. However, most studies are unable to find clear statistical links between payment-income imbalances and foreclosures. Finally, the institutional characteristics of state foreclosure procedures appear to have some influence on the decisions made by borrowers or lenders.

Relationships among problem loan rates

On a quarterly basis, longer term delinquencies are expected to follow the path of shorter term delinquencies with a lag. For example, FHA 60-day delinquencies should reflect movements in FHA 30-day delinquencies in prior months; 90-day delinquencies should reflect movements in 30-day delinquencies with even a longer lag. The logic, of course, is that unremedied delinquent loans move through this sequence of categories to end up in the 90-day or more category and ultimately in foreclosure.

Statistical tests confirm these expected relationships. For all three loan types, changes in 90-day delinquency rates are significant indicators of changes in the percentage of loans in foreclosure, and changes in 60-day delinquencies reliably portend changes in 90-day late loans, but changes in 30-day delinquency rates do not appear to be as reliable an indicator. In some cases, these shorter duration delinquency rates reflect future patterns of longer duration rates, but in other cases they do not. It is likely that there is more meaningless movement in 30-day delinquency rates than in the other rates, because normally reliable borrowers miss a single payment for one reason or another at times, but quickly become current again.

There is a very high correlation among default rates across loan types. Movements in FHA delinquency rates tend to mirror movements in VA delinquency rates. Movements in VA delinquency rates, as well as the percentage of VA loans in foreclosure, tend to mirror movements for both these categories for conventional loans, and so forth.

Statistical tests

Given the findings of previous studies and the statistical relationships among default rates of various durations and across loan types, it is likely that a common set of factors can help to explain the variation in default rates over time. The factors tested here include: changes in home prices, loan-to-value ratios, current versus historical mortgage interest rates, unemployment rates, income growth, divorce rates, consumer debt burdens, changes in interest rates affecting ARM payments and growth in self-employment. The first three factors tested are determinants of net equity; the next six affect income flows and/or reflect the ability to pay.

Changes in home prices—Changes in home prices provide nearly all equity gains after origination until very late into the term of the loan. Early in the life of a loan, very little principal is repaid. Generally, the relationship of home price changes to defaults is inverse. For example, if prices appreciate and equity builds, borrowers will likely make every effort to avoid delinquency problems and are less likely to face foreclosure, because they are more likely to be able to sell their home for more than the amount due on the loan after expenses. Several

measures of home price changes were tested, including the National Association of Realtors' (NAR) median price for existing homes sold (both adjusted and unadjusted for inflation) and the Census Bureau's index of constant quality new home prices (again, both adjusted and unadjusted for inflation).

Loan-to-value ratios—The loan-to-value (LTV) ratio determines the initial equity. The expected relationship with default rates is positive; if the LTV ratio is high and the initial equity is thin, the financial stake may not be large enough to compel borrowers to make their loan payments on time.

While mortgage lenders cannot control price appreciation, they can partially respond to debt burdens through careful underwriting and/or quality control.

Current versus historical interest rates—The difference between current and historical interest rates provides a guide to the market versus par value of a loan. The expected relationship is inverse for delinquencies, but ambiguous for foreclosures. If the current market rate is higher than the historical rate, borrowers holding loans at the historical rate are certain to try to avoid loan problems because their payments would rise if they were forced to acquire new loans (if possible at all) at the current rates following a default.

Lenders may have a different response. Lenders have limited influence over delinquencies, but do have choices concerning foreclosures. If the current market rate is greater than the historical rate, portfolio lenders may push forward with foreclosure proceedings. Because borrowers and portfolio lenders may react to the difference between current and historical interest rates in opposite ways, the relationship of this difference to the percentage of loans in foreclosure is ambiguous. Further, it is likely that expectations about changes in the difference are critical because mortgage loans are such long-term instruments. Consequently, it may be that what matters are the changes in the rate differential rather than the disparity itself.

Unemployment rates—The unemployment rate affects income flows. Default rates generally increase with rising unemployment. The variable chosen to represent unemployment is the Bureau of Labor Statistics' (BLS) civilian unemployment rate for 25- to 54-year old males. This unemployment rate provides a better gauge of cyclical movements in the economy over the past 25 years than the overall unemployment rate, because the latter rate is strongly influenced by shifts in the age and sex composition of the labor force.

Income growth—The expected relationship of income growth with default rates is inverse; as the ability to pay increases with income, loan problems are likely to diminish. The income variable is measured by changes in the Bureau of Economic Analysis' (BEA) real disposable personal income per capita.

Divorce rates—Divorces can affect both the ability to pay and the willingness to pay. The expected relationship with default rates is positive; as couples divorce, income that previously supported one household must now often support two. Further, in hotly contested divorces, disputes over property and financial responsibilities can result in the failure to make mortgage payments by either party.

Consumer debt—Consumer debt burdens can restrict a borrower's ability to pay. The expected relationship with default rates is positive. As consumer debt (excluding mortgage debt) rises relative to income, borrowers may be unable to meet all their financial obligations, including their mortgage payments. The variable is measured as the ratio of the Federal Reserve's consumer installment debt outstanding to BEA's personal income.

ARM rate changes—Changes in interest rates affecting ARM payments impact the ability to pay. The expected relationship with default rates is positive; as ARMs are adjusted upward, loan problems may rise. The variable is measured as the change from one year ago in the one-year constant maturity Treasury rate—the most common index used to adjust ARM rates. The variable enters the analysis only in the 1980s as ARMs grew in volume.

Self-employment growth—The growth in self-employment affects the stability of income flows. Self-employment income tends to be much more volatile than the generally stable flow from wage and salary employment. Therefore, the relationship with default rates is expected to be positive; as self-employment increases as a percentage of total employment, loan problems may rise. The variable is measured as the ratio of nonagricultural self-employed workers to all nonagricultural workers (BLS household survey).

Obviously, all of the measures of the variables as discussed are proxies. Further, practically all of these measures have statistical problems of their own limiting their reliability in measuring what they purport to measure. Even so, the results of the tests are quite interesting.

Results

Separate tests were done on conventional delinquencies of 60 days or more and on the percentage of conventional loans in foreclosure. Tests were also done on comparable measures for VA and FHA loans, resulting in a total of six separate tests. In all cases, the factors tested (taken together) explained virtually all the variation in the respective default rates by loan type.

Across all tests, the unemployment rate, prices and consumer debt appear to be among the most important factors tied to higher default rates. The unemployment rate showed the expected relationship and was statistically significant in explaining default rates in four of the six tests; while price increases showed the expected relationship and were statistically significant in all six tests. (Here, the NAR nominal median price measure performed best among the measures of price change.) Finally, the consumer debt variable had the expected relationship with defaults and was highly significant in five of the six tests.

The LTV and ARM variables were tested for conventional loans only. The LTV variable demonstrated the expect-

ed relationship with defaults and was highly significant in the conventional delinquency and foreclosure tests. The ARM variable demonstrated the anticipated connection with problem loan rates and was statistically significant in the delinquency test, but not in the foreclosure test.

The remaining variables—income, divorce rates, self-employment, and current versus historical mortgage rates—showed mixed results, but did not appear to be as important as the variables already discussed. The divorce variable showed the expected relationship and was highly significant in the VA and FHA delinquency tests, but was not significant in any of the other tests. Similarly, the self-employment and current versus historical interest rate variables appeared to influence conventional delinquency rates in the anticipated ways, but did not appear to matter much in the other tests. The income variable was not significant in any of the tests.

Although obviously not conclusive, the tests do produce some interesting results consistent with prior research and common sense. Trends in unemployment, home prices, loan-to-value ratios and consumer debt appear to be very significant contributors to the secular rise in default rates.

The possibility of a recession sometime within the next several years, which can't be ruled out, would almost certainly result in a temporary rise in default rates.

Institutional factors

These tests do not capture some institutional developments that also may have contributed to rising problem loan rates. The first has been discussed briefly: the effects of state foreclosure laws. Another is personal bankruptcy.

It has been suggested that state foreclosure laws influence the willingness of lenders to pursue foreclosure aggressively. If the process is extremely time-consuming, it may be more profitable for lenders to make financial concessions in order to resolve the deficiency rather than pursuing foreclosure. Because shifts in the nation's population with time contribute to a gradual shift in the geographical distribution of the housing stock and related mortgages, the national foreclosure rate could rise solely due to increased housing market activity in states with laws more conducive to foreclosure. Indeed, some of the fastest growing states during the 1970s and the 1980s, such as California, Texas and Florida, are also states that process foreclosures in shorter periods than the national average. As the share of loans increases in such states, the national foreclosure rate may drift up as a consequence.

To examine this possibility, a variable was created that measures the effects of shifts in housing market activity among states on the national average number of weeks required to complete foreclosure. Tests indicate that the expected inverse relationship with default rates was confirmed for all three loan types; as the length of time increases, some lenders may attempt to avoid the foreclosure process as much as possible. Consequently, the shift in the nation's population toward states with foreclosure laws that are simpler and less costly for lenders may have contributed to the secular rise in the percentage of loans in foreclosure. However, this conclusion is somewhat speculative.

Another institutional factor that may influence default rates is personal bankruptcy. A bankruptcy filing temporarily halts collection efforts by creditors; therefore, mortgage defaults may rise as bankruptcies rise. Unfortunately, testing the impact of personal bankruptcies on mortgage default rates is difficult. Research by the Administrative Office of the U.S. Courts—the organization that compiles data on bankruptcy filings—suggests that the consumer debt-to-income ratio is a critical determinant of bankruptcies. However, because a similar variable is probably an important cause of mortgage defaults, it is difficult to prove that bankruptcies per se contributed to the rise in mortgage default rates.

The significant liberalization of bankruptcy laws during the late 1970s made it easier to declare bankruptcy. As a result of that liberalization, the stigma attached to bankruptcy greatly diminished during the 1980s. These changing attitudes and increasing willingness to use bankruptcy made it likely that mortgage problems could increase as a result.

There is no doubt that bankruptcy filings are on the rise. In 1978, there were about 175,000 personal bankruptcies filed in the United States, or about 0.08 per capita; by 1988, there were about 750,000 filed, or about 0.30 per capita—nearly a four-fold increase per capita.

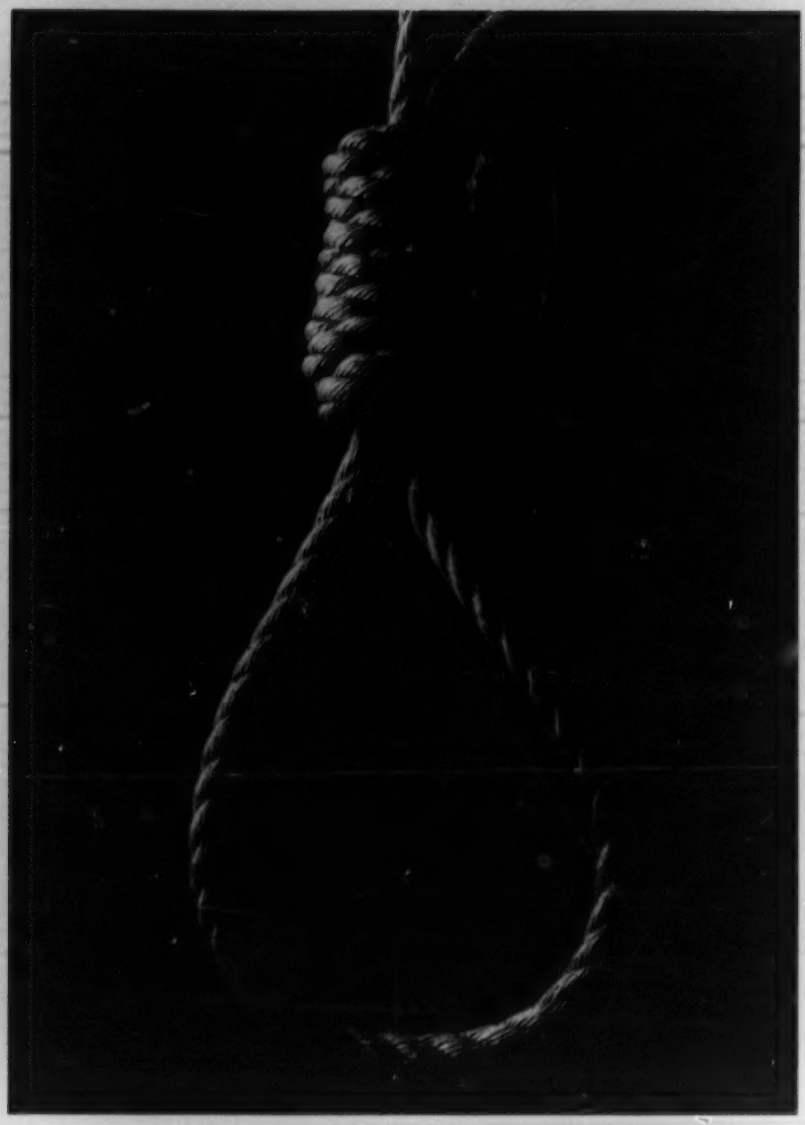
Outlook for delinquency and foreclosure problems

The decline in the delinquency rate since 1985 may have reached a trough in the short-run. The total delinquency rate for all three loan types was slightly higher in 1989 than in 1988. On the other hand, the earlier declines in delinquency rates are still contributing to declines in the percentage of loans in foreclosure. For all of 1989, the percentage dropped about 5 to 10 basis points from 1988 for conventional and VA loans and an impressive 20 basis points for FHA loans.

However, with delinquency rates showing few signs of decreasing further in the short run, the prospects for further declines in the percentage of loans in foreclosure are limited. It is more likely that the percentage will stabilize around current levels.

Over the long-run, the outlook for default rates hinges on the fundamental contributing factors discussed earlier. The most important ones likely include changes in home prices, consumer debt burdens, LTV ratios, the impacts of institutional factors, trends in unemployment rates, and, perhaps, changes in divorce rates. The direction each will take, in turn, is far from certain.

Nominal home prices are likely to increase at a more modest rate over the next decade than during the late 1970s and some of the 1980s. Price appreciation in these latter periods was



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strongly influenced by the explosive increase in household formations, coupled with extraordinarily low real after-tax mortgage interest rates. The demand pressures on prices from demographic changes will be much less pronounced in the 1990s. Further, real after-tax mortgage interest rates are likely to remain relatively high. Reduced demand from these sources—if not offset by other sources of demand or supply pressures—will likely mean slower price appreciation and slower equity accumulation. Because equity growth is critical in holding down default rates, modest price appreciation in the 1990s is not likely to be a strong force in reducing default rates. But equity growth will probably be strong enough to contribute to stability in those rates.

The outlook for consumer debt is less favorable. Consumers continue to amass debt at a rapid rate. Concerns about consumer debt accumulation have been raised many times in the past 50 years, but the economy has not faced the dire consequences often predicted. For lenders, though, there is reason for concern. Large debt burdens coupled with bankruptcy filings are hurting mortgage lenders. These factors are likely to continue to put upward pressure on default rates in the 1990s.

While mortgage lenders cannot control price appreciation, they can partially respond to debt burdens through careful underwriting and/or quality control. Loans very close to maximum ratios could be rejected. This would not prevent some borrowers from increasing their debt burdens sharply after a loan is made, but it would eliminate some high-risk borrowers that show a clear propensity to accumulate debt.

Lenders can also control LTV ratios. This factor will become even more important in the 1990s because price appreciation is likely to be much more modest. Stricter underwriting guidelines and quality control standards can be used to compensate for slower appreciation and to reduce defaults. Of course, reducing risk this way could be costly and involves business decisions. Some risk must be incurred to make a profit.

The outlook for the unemployment rate is for a modest increase in the next year or so, as the economy grows below its potential growth

rate. Over the longer term, however, the outlook is much better than 15 years ago. The surge in new workers from the baby boom generation is over. As the economy continues to grow in the 1990s, a labor shortage is more likely to develop than a labor surplus. This can be mitigated by immigration or other factors, but the outlook for the long-run unemployment rate is favorable.

Finally, the divorce rate appeared to peak in the early 1980s and is now coming down. This trend is likely to continue into the 1990s and should help put downward pressure on default rates.

Taken together, there are obviously many conflicting factors that are likely to play a role in determining default rates in the 1990s. The possibility of a recession sometime within the next several years, which can't be ruled out, would almost certainly result in a temporary rise in default rates. Matters are complicated further by the ongoing resolution of the thrift crisis. Disposition of properties may depress appreciation rates in some areas, thereby increasing the probability of default, or may affect defaults in ways that are difficult to anticipate currently. Still, there are not compelling reasons to believe that default rates will rise sharply in the 1990s. On the other hand, there are not compelling reasons to believe that they will continue to come down either.

Lenders will play a key role. Tighter underwriting standards and quality control guidelines can make a difference. Whether such standards and guidelines justify their added costs may well determine the future course of default rates. **MB**

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[1]See Thomas M. Holloway and Robert M. Rosenblatt, "Problem Loans: Trends, Causes, and Outlook for the Future," economics department, Mortgage Bankers Association of America (MBA), April 1990 (mimeo) for an expanded version of this article with much more technical and statistical detail.

[2]The estimates of "total" problem loans rates shown in Table 1 and Chart 1 and elsewhere in the article differ from estimates for the "all loans" category published in MBA's *National Delinquency Survey* (NDS) because the NDS includes a disproportionate number of mortgage bankers relative to other types of lenders. The estimates here adjust the NDS numbers to better reflect national averages. See the Holloway-Rosenblatt paper cited in footnote 1 for details.

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ECONOMIC TRENDS

The refinancing of mortgage loans is often an important component of total origination volume. For example, a survey of a dozen or so large mortgage banking companies revealed that refinancing volume in recent months accounted for 15 to 20 percent of total application volume. At the peak of refinancing activity in late 1986 and early 1987, nearly half of all origination volume involved refinancings.

An interesting aspect of refinancing is that, in most cases, it involves converting some home equity into cash. In this regard, refinancing is like home equity lines of credit, second mortgages and other methods to convert equity.

Given the obvious importance of refinancing, generally, and as a means to convert home equity into cash, in particular, it is not surprising that a recent article prepared by the Federal Reserve Board (Fed) on the subject makes interesting reading. The article, entitled "Mortgage Refinancing," appears in the August 1990 issue of the *Federal Reserve Bulletin*. The article begins with general comments about why homeowners refinance, then turns to reporting results from a nationwide survey of homeowners who were asked a series of questions about their mortgages.

In reviewing the reasons homeowners refinance, several motives emerge. First, and most important, homeowners refinance to reduce interest costs on their existing loans. As simple and obvious as this motive is, deciding exactly when to refinance and which mortgage instrument to use is complicated. Discounted, after-tax interest savings resulting from refinancing must be enough to offset after-tax closing costs. Because interest savings accrue with time, the length of time the homeowner plans to remain in the home is a key factor. Further, if interest rates are declining as they typically are when refinancing activity picks up, homeowners must decide whether savings gained by waiting for rates to drop further offset savings lost by paying interest at a higher rate while waiting. Finally, homeowners must weigh the advantages and disadvantages of ARMs versus FRMs.

A second major motive to refinance is to cash out equity to use for other purposes, such as financing home improvements, buying consumer goods, paying off other debts and the like.

A third motive is to reduce monthly payments even if interest rates are not lower. This can be accomplished, for example, by refinancing a fully amortizing 30-year FRM with 20 years remaining by a new 30-year FRM at the same interest rate.

The Fed survey tells us a great deal about homeowners and their mortgages. Table 1 summarizes some of the basic findings. To begin with, 46 percent of homeowners nationwide own their homes free and clear. However, there are significant regional differences. In the Midwest and South, 49 percent of homeowners had no mortgage debt; but in the Northeast, it was 44 percent, and in the West, only 34 percent. These latter regions had brisk turnover of existing homes during much of the 1980s, which probably contributed to the relatively large proportion with mortgage debt.

Of homeowners who have mortgage debt, 20 percent had refinanced at the time of the Fed's survey and 15 percent had home equity loans, with some overlap in these two groups. Of those who refinanced, nearly 60 percent cashed out some equity above the amount needed to cover closing costs.

Table 2 shows the major uses of cashed-out equity arranged by the means used to convert the equity. As the table shows, regardless of the means of converting equity, the two single most important uses are for home improvements and the repayment of other debts. For home equity lines of credit, use for education expenses, medical expenses and auto purchases was also common. Changes in tax law in recent years almost certainly spurred the use of home equity lines of credit for these purposes. In the case of refinancings, use of cashed-out equity for these purposes was much less common. A large item in the "other" catego-

Economic Trends *continued on page 135*

TABLE 1

Holdings of First Mortgages and Refinancing Activity Among Homeowners, 1989
(Percentages)

	U.S. Total	Regions			
		Northeast	Midwest	South	West
Share of homeowners:					
Without mortgages	46	44	49	49	34
With mortgages	54	56	51	51	66
Share of homeowners with mortgages who:					
Refinanced their mortgages[1]	20	27	20	13	26
Held a home equity loan	15	26	12	11	14

Source: Federal Reserve Board
1. Share with current mortgages that were refinanced at some time in the past.

TABLE 2

Uses of Equity Converted to Cash[1]
(Percentage of Equity Converters Citing Use)

Use	Home Equity Line of Credit		Traditional Second Mortgage	Refinancing Resulting in Liquidized Equity
	Initial Use	Subsequent Uses		
Home improvement	38	58	45	46
Repayment of other debts	40	28	35	36
Education	11	20	1	3
Auto, truck purchases	7	30	5	5
Medical expenses	3	16	0	2
Other[2]	26	43	27	34

Source: Federal Reserve Board
1. Uses may sum to more than 100 percent in individual columns due to multiple uses of the same funds.
2. Includes purchases of furniture, appliances, boats and other durable goods, vacations, real estate investments and business uses.

VITAL STATISTICS

INTEREST RATES & YIELDS
1- TO 4-FAMILY MORTGAGES

	FHA OPINION SURVEY	FHFB			FNMA		FHLMC	
1990	FHA New Homes[1]	CONVENTIONAL[2] FRM	ARM	Median Cost of Funds SAIF Institutions	1-Yr. ARM	FRM Conv.	ARMs	FRMs
MAY	10.49%	10.54%	9.28%	7.58%	8.45%	10.29%	8.59%	10.48%
JUN	10.21	10.57	9.33	NA	8.27	9.98	8.49	10.16
JULY	10.15	NA	NA	NA	8.14	9.88	8.43	10.04
AUG	**NA**	**NA**	**NA**	**NA**	**7.96**	**10.00**	**8.35**	**10.10**

SELECTED SECURITIES

		PRIME COMMERCIAL PAPER	U.S. GOVERNMENT				
1990	FEDERAL FUNDS RATE	(3-Month)	6-Month	1-Year	3-Year	10-Year	A-Rated Utility
MAY	8.18%	8.25%	7.76%	8.32%	8.69%	8.76%	10.04%
JUN	8.29	8.14	7.63	8.10	8.40	8.48	9.85
JULY	8.15	7.99	7.52	7.94	8.26	8.47	9.96
AUG	**8.13**	**7.88**	**7.38**	**7.78**	**8.22**	**8.75**	**10.29**

CURRENT SECONDARY MARKET YIELDS

SPREADS
(Basis Points)

1990	GNMA[3]	FNMA[3]	FHLMC[3]	GNMA Minus 10-Yr. Govt.	FNMA Minus 10-Yr. Govt.	FHLMC Minus 10-Yr. Govt.
MAY	9.99%	9.93%	9.92%	123	117	116
JUN	9.73	9.73	9.72	125	125	124
JULY	9.66	9.66	9.66	119	119	119
AUG	**9.80**	**9.75**	**9.75**	**105**	**100**	**100**

SECONDARY MARKET ACTIVITY
(Dollars in Millions)

	FNMA*				FHLMC				GNMA	
	Portfolio		Mortgage-Backed Securities						Pass-Through Securities	
1990	Commitments**	Purchases	Outstanding	Issued	Commitments To Sell	Commitments To Buy	Mortgages Purchased	PCs Issued	Applications	Issued
MAY	$1,960	$1,630	$257,218	$7,081	$5,093	$8,502	$6,064	$5,792	$7,038	$5,197
JUN	2,089	1,802	263,330	8,266	5,549	11,183	5,856	5,546	6,851	5,739
JULY	2,215	2,304	268,052	6,869	4,507	5,851	4,527	4,247	8,553	5,553
AUG	**2,302**	**2,134**	**275,227**	**9,378**	**NA**	**NA**	**NA**	**NA**	**NA**	**NA**
1989 TOTAL	27,409	22,518	---	69,764	85,408	86,263	78,589	73,518	60,149	57,522
1988 TOTAL	23,435	23,110	---	54,878	41,271	70,669	44,075	39,777	58,578	58,531
7 MONTH AVG. 1990	1,905	1,909	---	7,932	5,993	8,005	5,779	5,905	5,457	5,223
1989	2,136	1,584	---	4,676	5,979	6,969	5,595	5,158	4,113	4,337
1988	2,202	2,149	---	4,206	2,826	5,369	3,148	2,702	4,361	4,067

*FNMA year to date averages are for eight months.
**Does not include standby commitments issued, but includes standby commitments converted.

HOUSING ACTIVITY

RESIDENTIAL STRUCTURES

(Units in Thousands, Seasonally Adjusted Annual Rates)

	BY TYPE OF UNIT						BY REGION							
	HOUSING STARTS			BUILDING PERMITS			HOUSING STARTS				BUILDING PERMITS			
1990	Total	1-4 Units	5+ Units	Total	1-4 Units	5+ Units	Northeast	Midwest	South	West	Northeast	Midwest	South	West
MAY	1,206	933	273	1,065	853	212	127	256	487	336	124	218	410	313
JUN	1,189	931	258	1,108	844	264	113	241	535	300	121	224	428	335
JULY	1,147	898	249	1,082	838	244	110	223	494	320	111	227	428	316
AUG	**1,127**	**872**	**255**	**1,036**	**818**	**218**	**119**	**234**	**441**	**333**	**113**	**224**	**402**	**297**
1989 TOTAL	1,376	1,059	318	1,338	999	340	179	266	536	396	179	252	505	402
1988 TOTAL	1,488	1,140	348	1,456	1,070	386	235	274	575	404	230	266	544	416
8 MONTH AVG. (SAAR)														
1990	1,281	995	286	1,208	913	295	141	273	507	361	137	270	453	349
1989	1,416	1,079	337	1,343	999	344	193	268	556	400	188	255	508	392
1988	1,473	1,132	342	1,433	1,057	376	256	266	564	387	246	259	533	395

HOME SALES

(Units in Thousands)

	EXISTING HOMES			NEW HOMES		
1990	Sold (SAAR)	Available for Sale	Months Supply At Current Sales Rate	Sold (SAAR)	Available for Sale	Months Supply At Current Sales Rate
APR	3,330	2,660	9.6	533	363	8.3
MAY	3,300	2,740	9.9	536	359	8.2
JUN	3,330	2,650	9.6	561	353	7.7
JULY	**3,440**	**2,630**	**9.2**	**548**	**349**	**7.8**
1989 TOTAL	3,440	---	---	650	---	---
1988 TOTAL	3,594	---	---	676	---	---
7 MONTH AVG. (SAAR)						
1990	3,389	---	---	565	---	---
1989	3,434	---	---	647	---	---
1988	3,476	---	---	668	---	---

VALUE OF NEW PRIVATE CONSTRUCTION PUT IN PLACE

(Units in Billions of 1987 Dollars, Seasonally Adjusted Annual Rates)

1990	Total[5]	1-Unit	2+ Units	Nonresidential
APR	$313.8	$109.7	$18.7	$94.7
MAY	306.0	105.8	19.1	93.3
JUN	301.2	101.9	17.1	95.0
JULY	**302.0**	**100.2**	**16.8**	**97.2**
1989 TOTAL	308.5	108.3	20.7	96.0
1988 TOTAL	314.4	112.0	21.4	93.5
7 MONTH AVG. (SAAR)				
1990	308.8	108.0	18.0	95.1
1989	312.6	111.0	21.4	95.7
1988	314.9	111.7	21.6	93.8

LENDER ACTIVITY

LONG-TERM MORTGAGE LOANS CLOSED
By Type of Institution and By Type of Unit
(Dollars in Millions)

	1-4 UNITS					5+ UNITS					NONRESIDENTIAL				
	Total[3]	Mortgage Bankers	Savings & Loans[7]	Commercial Banks	Life Companies	Total[3]	Mortgage Bankers	Savings & Loans[7]	Commercial Banks	Life Companies	Total[3]	Mortgage Bankers	Savings & Loans[7]	Commercial Banks	Life Companies
1990															
JAN	$34,012	$9,802	$11,023	$12,578	$247	$3,226	$866	$882	$777	$377	$17,217	$149	$759	$12,928	$3,139
FEB	30,305	9,867	9,964	10,129	27	3,041	682	803	768	551	14,039	202	881	9,469	3,320
MAR	33,747	8,703	12,620	12,014	29	2,765	557	1,120	802	61	18,878	102	893	14,794	2,978
APR	**34,102**	**8,406**	**12,949**	**12,405**	**28**	**1,820**	**154**	**1,154**	**317**	**50**	**16,939**	**421**	**811**	**12,240**	**3,048**
1989															
TOTAL	352,026	65,606	157,676	123,193	1,443	31,145	4,443	13,469	7,669	2,786	149,950	1,688	14,476	106,424	25,675
1988															
TOTAL	383,566	85,307	188,871	101,863	3,331	38,158	4,526	20,551	6,920	3,732	181,604	1,032	24,368	124,106	29,986
4 MONTH AVG.															
1990	33,042	9,195	11,639	11,782	83	2,713	565	990	666	260	16,768	219	836	12,358	3,121
1989	26,777	5,325	12,755	8,326	71	2,617	295	1,374	531	173	10,233	86	1,523	6,827	1,662
1988	25,448	6,131	11,994	6,897	101	2,416	243	1,394	385	240	14,306	47	1,921	10,527	1,534

MORTGAGE INSURANCE
(Units in Thousands, Dollars in Millions)

	APPLICATIONS RECEIVED (Units)				LOANS INSURED							
	TOTAL	FHA[8]	VA	PRIVATE	TOTAL		FHA		VA		PRIVATE	
					Units	Amount	Units	Amount	Units	Amount	Units	Amount
APR	149	88	16	45	110	$8,601	65	$4,267	15	$1,157	30	$3,177
MAY	155	93	17	45	112	8,919	65	4,382	15	1,236	32	3,301
JUN	150	90	17	43	113	9,021	64	4,289	16	1,309	33	3,423
JUL	**144**	**84**	**15**	**45**	**119**	**9,666**	**67**	**4,509**	**15**	**1,254**	**37**	**3,903**
1989 TOTAL	1,687	990	194	503	1,274	95,956	726	45,893	183	12,946	365	37,117
1988 TOTAL	1,755	949	211	595	1,334	98,012	699	42,577	211	15,771	424	39,664
7 MONTH AVG.												
1990	145	88	17	40	113	8,838	66	4,342	17	1,326	30	3,170
1989	137	81	15	41	99	7,464	56	3,485	15	1,167	28	2,812
1988	154	85	17	52	109	7,910	57	3,453	17	1,247	35	3,210

NA—Not Available; SAAR—Seasonally Adjusted Annual Rate

[1]Secondary market gross yields. Numbers shown for each month are the average of yields from the first day of the month shown and the first day of the subsequent month.

[2]Effective rate on loans closed.

[3]Securities for 0- to 30-day delivery.

[5]In addition to the categories of private construction shown, the total also includes these categories: residential improvements, railroads, electric light and power, gas, telephone and telegraph, petroleum pipelines, and farm nonresidential.

[6]In addition to the categories shown, the total also includes private pension funds, private MBS conduits, state and local retirement funds, federal credit agencies, mortgage pools, and state and local investment agencies.

[7]Savings & Loans and Mutual Savings Banks.

[8]FHA applications received includes the Direct Endorsement Program.